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MICHAEL RODAK, JR., CLERK

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1974

No. 74-504

WILLARD BARRY and HARRIET BARRY,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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The Petitioners, WILLARD BARRY and HARRIET BARRY, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on August 5, 1974.

OPINIONS BELOW

The opinions of the District Court and the Court of Appeals, not yet reported, appear in the appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on August 5, 1974, and this petition for certiorari was filed within ninety (90) days of that date. This Court's jurisdiction is invoked under 28 U.S.C. Section 1254 (1).

QUESTIONS PRESENTED

I Where, for purposes of income tax depreciation of a parcel of commercial real estate consisting of a building and land, it is required (as it usually is) —

A) For the taxpayer to establish a separate valuation for the (depreciable) building and the (non-depreciable) land, where no such apportionment was made at time of acquisition, and

B) For the taxpayer to establish the estimated remaining useful life of said building at time of acquisition.

What facts and data and factors should be considered and what weight should be given to them respectively?

II Where a lessee, under the terms of a lease, has the unrestricted right, but no obligation, to demolish a building owned by the taxpayer lessor, with no additional consideration to lessor in the event of such a demolition, and where, almost six years after the beginning of the lease, the lessee decides to and does in fact demolish said building, is the lessor —

A) Entitled to annual income tax depreciation deductions on said building up to the time of said demolition?

B) Entitled to an income tax deduction in the year of demolition or otherwise for the balance of the undepreciated cost basis of said building remaining at the time of demolition?

STATUTES AND REGULATIONS INVOLVED

(1954 Internal Revenue Code)

Section 165 – LOSSES – Appendix page A-16

Section 167 – DEPRECIATION – Appendix pages A-16, A-17

Section 1011 – ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS – Appendix page A-17

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TREASURY REGULATION 1.1001-1 – COMPUTATION OF GAIN OR LOSS – Appendix page A-31

STATEMENT OF THE CASE

Petitioners will be referred to as Taxpayers, and Respondent referred to as IRS.

This case involves deficiencies asserted against the Taxpayers for federal income taxes for the years 1959 and 1960. Taxpayers paid the amount of the asserted deficiencies and after claims for refunds were denied, filed a suit for refund in the District Court. During trial in the District Court all differences were resolved except those relating to the claims of the Taxpayers for depreciation deductions for the years 1959 and 1960 and demolition loss for the year 1960, all relating to a commercial building located in downtown Colorado Springs, Colorado, owned by Taxpayers in 1959 and 1960.

Taxpayers acquired complete ownership of the said real estate (land and building) on June 1, 1959 by inheritance. In the federal estate tax proceedings of the ancestor's estate, said real estate was valued by IRS at $160,000, with no allocation or apportionment made between the land and building, and with the optional valuation date (one year after death) of June 1, 1960 used. There was no change in the existing lease nor in the structure or condition of the building between June 1, 1959 and June 1, 1960. On their 1959 income tax return Taxpayers claimed depreciation deduction on said building for period from June 1, 1959 to December 31, 1959 and for the year 1960 claimed depreciation for the period from January 1, 1960 to November 15, 1960, on which date said building was demolished by the lessee of said lease. For purposes of computing the said depreciation deductions, Taxpayers allocated $45,000 to the building, based upon the similar ratio and allocation of value between the land and said building by the local county assessor (for real estate taxes) and the similar ratio and

allocation as made by the Colorado Revenue Department for state income tax purposes of the Taxpayers for the years 1959 and 1960.

The demolition of the said building was done by the lessee of a lease which was in effect at the date of the ancestor's death on June 1, 1959, which lease had been entered into in October, 1954, by Taxpayers' ancestor as lessor originally for five (5) years beginning January 1, 1955, and extended for an additional five (5) years (to January 1, 1965) by the option of the lessee exercised before the June 1, 1959 death of the ancestor, rental for the original and extended term being $13,000 per year with lessor to pay insurance and real estate taxes.

Said lease contained a clause permitting but not requiring the lessee at any time to demolish the building with no additional payment to the lessor (Taxpayers) in event of demolition.

For five years beginning January 1, 1955 the lessee subleased the building at same rental of $13,000 per year, to several commercial tenants (a bank and a retail store). In August, 1960, being about three months after the valuation date, the lessee decided to demolish the building, which was done in November, 1960.

The IRS refused to permit Taxpayers any deductions either for depreciation on said building for years 1959 and 1960 or for demolition loss in year 1960.

In the District Court the evidence on behalf of the Taxpayers was addressed to the following issues:

(a) That the Taxpayers by law were entitled to a reasonable allocation of about $40,000 to said building, of the total $160,000 acquisition cost as of June 1, 1960, as the original cost basis for said

building for income tax depreciation, and that Taxpayers were entitled to reasonable depreciation deductions for years 1959 and 1960.

(b) That straight line depreciation on said building should be computed on a reasonable estimated remaining useful life of about 10 years up to date of demolition for years 1959 and 1960.

(c) That for 1960, the year of demolition, the Taxpayers should be allowed to take a deduction for the remaining undepreciated cost basis of the building to cover the unreimbursed loss to the Taxpayers occasioned by the loss by demolition of their building.

Except for the ultimate determination of the proportionate value to be allocated to the *building* on the effective valuation dates, the operative facts were not disputed.

The District Court found that on the effective valuation date or dates the said *building* had *NO FAIR MARKET VALUE* and thus considered that it was not necessary to make any determination of the remaining issues (b and c) as above set forth by the Taxpayers. The Sixth Circuit agreed in all respects with the District Court.

REASONS WHY WRIT SHOULD BE GRANTED

I THE SIXTH CIRCUIT MADE AN ERRONEOUS APPLICATION OF DUBERSTEIN AND OF THE CLEARLY ERRONEOUS RULE TO THE FACTS OF THIS CASE, WHICH ERROR WILL AFFECT NUMEROUS TAXPAYERS ALL OVER THE UNITED STATES AND WILL RESULT IN A LACK OF UNIFORMITY IN THE ADMINISTRATION OF THE INCOME TAX LAWS.

In this case the Sixth Circuit stated that it was bound by *Duberstein* v. *United States,* 363 U.S. 278, and as that case related to the Clearly Erroneous rule (Rule 52 (a) F.R.C.P.) as applied to the facts of our case.

Taxpayers submit that this reliance on *Duberstein* was improper in this instant case of sharp factual dispute, characterized by the Sixth Circuit (Appendix page A-20) as a "classic factual dispute". Taxpayers see nothing "classic" in the dispute, but are of opinion that the totality and sheer weight of the evidence is overwhelming in their favor. How can *Duberstein,* with not the slightest factual dispute, have any reference to a case such as ours?

In *Duberstein* the Sixth Circuit, by a process of strained and tortuous reasoning, (quite similar to the reasoning in our case) came to the clearly erroneous conclusion that a simple quid pro quo business payment was a non-taxable gift.

The *Duberstein* doctrine was promptly criticized and analyzed by Erwin Griswold in 74 Harvard Law Review 81. Dean Griswold there was apprehensive (and prophetically so in our case) that *Duberstein* would be construed so that the idiosyncracies or individualistic or result-oriented

or emotional decisions of Trial Courts (with resultant lack of uniformity) would thereby tend to be upheld by reviewing courts. The same misgivings had been voiced in the concurring opinion of Justice Frankfurter. Also applicable to our case is Griswold's statement that where no *DIRECT FACT* is disputed the question is one of LAW.

The Sixth Circuit, with an unrealistic reasoning process (similar to our case and *Duberstein*) arrived at the wrong legal conclusion of the tax consequences where there was no factual dispute in:

> *Snow* v. *United States* — 94 Supreme Court 1876
> *Cordovan* v. *Dayton Rubber Co.* — 364 U.S. 299

The decision in our case is important to every taxpayer who acquires a parcel of commercial real estate having a building on it, because he cannot compute or take the proper amount of annual income tax depreciation on the building to which he is entitled until he has made an apportionment of the total property value at time of acquisition as between the land and building and a determination of the estimated remaining useful life of said building when acquired.

In this case the Taxpayers made such a reasonable apportionment between land and building and an estimate of the remaining useful life of their building, using generally accepted factors. The IRS and the District Court rejected Taxpayers' said reasonable allocation of value and refused to permit Taxpayers to take any depreciation deductions or demolition deduction on said building.

The Sixth Circuit upheld the decision of the District Court as not being clearly erroneous. Taxpayers now submit to this Court that the decision of the Sixth Circuit was erroneous, for the following reasons:

A) The overwhelming totality and weight of the evidence (as follows) in favor of the Taxpayers was disregarded:

1) (a) Testimony of local county assessor, showing that office to be familiar with all aspects of the particular building in 1959 and 1960, with actual assessed value of *building* for real estate taxes for those years at 40% of the total property valuation (though nearby bank building showed ratio of 89% for building and 11% for land).

(b) Original records of county assessor, setting forth in detail all aspects of the said building in 1959 and 1960 up to time of demolition (such as floor area, structural aspects of the building and its components, plumbing, wiring).

2) Testimony of Taxpayer owner, (Harriet Barry) who had personally inspected the building in June, 1959, that on valuation dates in her opinion the building was worth about $60,000, with estimated remaining useful life of 20 years, and that she never wanted the building demolished, but knew she was bound by the provisions of the lease she inherited.

3) Testimony of Taxpayer (Willard Barry) who had, as ancestor's co-executor and attorney, handled the federal estate tax valuation of said property, and had personally inspected the building in June, 1959, that building was worth about $60,000 on valuation dates with estimated remaining useful life of 20 years, that he did not attempt

to break the lease because there was no reasonable basis for such action.

4) Original fire insurance policies for $60,000 coverage on the building on valuation dates, together with $72,680 appraisal of the building upon which amount of fire insurance was based (i.e. to comply with 80% co-insurance clause).

5) Written 1964 ruling by Colorado Revenue Department, allocating $45,000 (of total Colorado inheritance tax valuation of $145,000 for the property) to the building for depreciation on same Taxpayers' Colorado state income tax returns for 1959 and 1960.

6) Testimony of Eugene Parker, Cleveland, Ohio, lawyer specializing in tax aspects of real estate for over 40 years, that the ratio of value (between land and building) used by local county assessors was universally followed by owners of commercial real estate in making the same apportionment for income tax depreciation purposes, and that this method of apportionment was usually acceptable to the IRS.

7) Testimony of Arthur Haigler, real estate broker in 1959 and 1960 in Colorado Springs, Colorado, and who had acted as real estate consultant to Taxpayers' ancestor's estate for federal estate tax valuation of said property, that on valuation dates the building was worth $50,000 with estimated remaining life of 5 years.

8) Albert Balliett, captain of Colorado Spring fire department, knew the building in 1959 and

1960, testified that he would not call the building unsafe at that time.

9) Lease proposed by Levy and his correspondence with Taxpayers' ancestor indicating that in 1959, while Levy's Fashion Bar store (as a sub-tenant) was occupying the building at rental of $1,000.00 per month, Levy wanted to enter into a long term lease of said building, without any right to demolish the building, and at a rental substantially more than his current rent.

10) Taxpayers' ancestor, with no objection from IRS, took regular annual depreciation deductions *on the same building, with same lease in effect,* for years 1955, 1956, 1957, 1958 and 1959 up to her decease on June 1, 1959.

B) On behalf of IRS, the District Court and Sixth Circuit both basically and erroneously relied upon:

1) Albert Curry, real estate expert for IRS, who in 1972 "appraised" a building he had never inspected and which building had been demolished in 1960, who testified that the building had no value at all on valuation dates.

2) Levy, (by ex parte affidavit) owner of retail store known as Fashion Bar which as sub-lessee occupied said building during 1957, 1958 and 1959 at rental of $1,000 per month, stated that building was no good on valuation dates.

The law applicable to the admissibility and weight and relevancy of all of the above testimony need not be elaborated, except for A (1), and B (1) and (2), as follows:

A (1) — (Improperly rejected) Testimony and records of local county assessor. Because the local county assessor normally (as in this case) makes his official, contemporaneous, disinterested, and professional allocation between land and buildings for real estate taxes, his allocation is usually either completely accepted by IRS and the Courts or at the very least is given great weight. In our case both the testimony and the original records of the local county assessor were completely disregarded. *We know of no case* (except this one) *where the county assessor's ratio or apportionment between land and building was totally disregarded.* The usual respect accorded to the county assessor's apportionment is shown in the following authorities:

J. Libor — T. C. Memo 1965 — 243

2554 Creston Corp. v. *Commissioner* — 40 T.C. 932 (1963)

700 Madison Inc. v. *U.S.* — 203 F. Supp. 184

World Publishing Co. v. *Commissioner* — 299 F2d 614

B) (1) ALBERT CURRY (Improperly received) — In essence, both the District Court and the Sixth Circuit accepted (over objection of Taxpayers) the incredible testimony and opinion of IRS real estate expert Curry as decisive that on the effective valuation dates the Taxpayers' building had *no value whatsoever.* Taxpayers submit that Curry's testimony and opinion should be given no weight for the following reasons:

a) Curry never inspected the building demolished in 1960, but in 1972 made what actually was a hearsay, hypothetical guess at the valuation of the building many years earlier. If Curry made any "appraisal" in 1972 it was only of the *land*, which was not an issue in the case (see *J. Libor*, supra). (Appendix A-32, 33, 34)

b) Curry improperly determined that the traditional real estate appraisal approach of capitalization of net income was not applicable, when this approach is the *only one* set up by the IRS in a similar apportionment procedure. See Treasury Regulation 1.165-3, (Appendix pages A-29, 30).

c) Curry, arbitrarily, rejected another traditional real estate appraisal approach (reproduction cost less depreciation) and relied entirely upon the "comparable sales" approach. Of all approaches, this latter one was the least valid in this particular case, because there were here (and rarely are) *no sales at all of buildings* (separate from land) much less a "comparable" sale of such a *building*. Curry cited the sale of nearby parcels of *land* (Appendix pages A-35 to 42, incl.), one (Sale No. 6) being *vacant land*, certainly not in any sense "comparable" to our parcel with a building on it. The other five "comparables" admittedly were all acquired "for development" so for that reason alone, and without further inquiry, Curry, in his "appraisals" *assumed* that all the buildings on all the "comparable"

parcels were totally worthless when acquired. On that unfounded assumption alone he attributed all of the various purchase prices of the "comparable parcels" solely to land value. This unsupported assumption (Appendix pages A-33, 34) in effect begged and disregarded the question of the respective valuations of the *buildings* on the parcels cited by Curry as comparable properties. The non-sequitur leaky syllogism results:

(Assume) Building on Parcel A is worthless
Parcel A is near Parcel B

(therefore) Building on Parcel B is worthless.

d) Curry, arbitrarily and erroneously, refused to attribute *any value* to the Taxpayers' building even though, in same condition as it was on valuation dates, for five years after the lease began the building was used as banking quarters and as a retail store at substantial rental ($13,000 per annum) (Appendix pages A-39, 40, 41, 42) and with the sub-tenant in 1955 spending an additional $25,000 for alterations to the building.

e) Curry (Appendix page A-42) and both Courts (Appendix pages A-10, 11, 12, 23, 42) improperly considered as a valuation factor the opinion of Curry that on the valuation dates the building did not represent the "highest and best use" of the property. Though this appraisal approach may be proper in condemnation proceedings, it is wholly improper in our case. We need not cite real estate appraisal

texts to point out that many existing valuable commercial buildings do not represent the highest and best use of that parcel, but that fact certainly has no bearing on the present value of that building to the owner.

f) Even though during the lease term the said building was occupied by sub-lessees continuously for 5 years beginning January 1, 1955 at annual rental of $13,000, plus $25,000 spent for alterations in 1955 and Levy's Fashion Bar retail store during that period on June 1, 1959 was located in the building, Curry still maintained (Appendix pages A-39 to 42 incl.) that this *actual use and substantial rental* for the use of the building was not at all inconsistent with his opinion that during those same periods the building had absolutely *no value whatsoever.*

g) Curry *assumed* (Appendix page A-35) that the property on the valuation dates without the building would have produced as much rental income as it did with the building, although there was no testimony or evidence of any nature upon which to base this assumption.

Curry's testimony in this case, accepted fully by both Courts, is reminiscent of that of Sir Thomas Bacon, famous jurist, who in 1665 in a witchcraft trial, testified as an expert that he knew *as a fact* that such things as witches actually existed.

B) (2) **LEVY AFFIDAVIT** (Improperly received) -- Although the Sixth Circuit described it as "testimony", (Appendix pages A-24, 25) and relied on it, Taxpayers had pointed out on appeal, and here again set forth that *Levy did not testify*. The contents of Levy's "testimony", accepted by the District Court (Appendix page A-6) and by the Sixth Circuit were actually conflicting statements made in an ex parte 1972 affidavit, presumably prepared by IRS, with no notice or opportunity for cross-examination to Taxpayers. When first tendered by IRS to the District Court, the Court commented "Levy's affidavit certainly is not admissible for any purpose", yet the Levy affidavit was not only finally received but was accorded substantial probative weight by both Courts. (Levy was owner of Fashion Bar ladies' wear retail store).

It should be noted (in connection with the idea that in the application of the Clearly Erroneous rule great respect should be given to findings of Trial Court because it sees and hears the live witnesses), that of all the testimony on behalf of IRS, all was by deposition or affidavit except for Curry. Absent *full acceptance* of *all* of Curry's improbable testimony the IRS position in this case had absolutely no basis.

The opinion of the Court of Appeals sets forth certain testimony of Curry, culled to support its decision. Because in the decision of both Courts, the testimony of Curry was fully accepted and considered as decisive, (and so that the testimony so quoted can be considered in proper context)

we have included additional Curry testimony (Appendix pages A-35 to 42 incl.).

C) The Sixth Circuit and the District Court erroneously applied and misinterpreted the applicable IRS rules.

1) Though both Courts here required Taxpayers to sustain the burden of proving the *FAIR MARKET VALUE* of Taxpayers' *BUILDING* as and when permanently affixed to land, our case properly did not involve any issues of *fair market value* of a property. The property (land and building) was valued overall at $160,000 for federal estate tax purposes. This case properly put in issue only the determination of the proportionate share of this total value to assign to the building for income tax depreciation purposes. *At no place in any IRS statutes or rules* is there any *mention or reference* to *"fair market value"* when determining an apportioment between land and building. Yet the District Court (Appendix pages A-3, 4, 5, 8, 12, 13, 14) and Sixth Circuit (Appendix pages A-16, 18, 21, 25, 26, 27) required the Taxpayers to sustain the impossible "burden" of proving a "fair market value" for the *building*. The relevant and *only* pertinent Treasury Regulation is:

> "§ 1.167 (a) -5 Apportionment of Basis.
> In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and non-depreciable property for a lump sum, as for example, buildings and land, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the

> time of acquisition bears to the value of the entire property at that time. . . ."

A substantial stone *building,* attached to land, as in this case, normally is not bought or sold, and so does not have a "market", as is recognized by the phraseology of the above Regulation. Statements about "fair market value" for a *building* (affixed permanently to land) so are a plain contradiction in terms and not consistent with the above Regulation.

In this case taxpayers proved the intrinsic value, or proportionate value of the building by all the accepted methods. But the District Court, upheld by the Sixth Circuit, saddled Taxpayers with the insurmountable and improper burden of *proving* something not possible to *prove* and not required to be proved under the IRS rules, i.e. FAIR MARKET VALUE of the BUILDING as such.

2) The Sixth Circuit didn't even mention nor consider Taxpayers' contention on appeal that in this case the District Court clearly erred when it put the burden of proof *for this particular apportionment of value* on the Taxpayers.

The opinion of the District Court (Appendix pages A-2, 3, 4, 5, 12, 14) stated that its assumption that Taxpayers had the burden of proof and didn't sustain it was important if not decisive. On appeal, Taxpayers set forth why *in this case* it was improper to put the traditional burden of proof on the Taxpayers as follow: (quoted from Taxpayers' brief on appeal) —

"In general, the burden of proof in any case rests upon the plaintiffs, and this was dwelled upon at length by the trial Court in his opinon.

"However, for the problem we have, involving the setting up of a commercial property on the books of the taxpayer to arrive at a value for depreciation purposes of a building, it would seem that the provisions of the 1954 Internal Revenue Code shift the burden of proof in the case of the determination of basis for depreciation to the IRS.

"Mertens, Vol. 4, Chap. 23, Pages 112 and 113 — it is stated that 'Generally, depreciation so claimed will be changed only where there is a clear and convincing basis for change.

" 'These Regulations mark a substantial change in the position of the Treasury Department from the position maintained in the Regulations under the 1939 Code after 1934 during which time the Regulations provided that the burden of proof rested on the taxpayer to sustain the deduction claimed. Actually these Regulations appear to be reverting to the rules prior to 1934. Obviously, there is a material difference between (1) the rule presently in effect that the deduction taken by the taxpayer will not be disallowed unless there is a clear and convincing basis for a change and (2) the rule prior to 1956 that the burden of proof rests upon the taxpayer to sustain the deduction claimed.' "

The Sixth Circuit did not even mention nor pass on this crucial claimed *error of law,* which alone should have caused the decision of the District Court to be reversed.

REASONS WHY WRIT SHOULD BE GRANTED

II TO RESOLVE THE CONFLICTING RULINGS OF DIFFERENT COURTS OF APPEAL RELATING TO ALLOWABLE INCOME TAX DEDUCTIONS FOR OWNERS AS LESSORS OF COMMERCIAL BUILDINGS DEMOLISHED BY LESSEES UNDER PROVISIONS OF LEASES WHICH PERMIT, BUT DO NOT REQUIRE, SUCH DEMOLITION, WITH NO ADDITIONAL PAYMENT TO LESSOR REQUIRED.

The opinion of the Court of Appeals in our case (Appendix page 27) sets forth that the Ninth Circuit (*Feldman* v. *Wood,* 335 F2d 264) and the Fifth Circuit (*Hightower* v. *U.S.,* 463 F2d 182) permit such a lessor to take a demolition loss deduction and that the Seventh Circuit (*Landerman* v. *Commissioner,* 454 F2d 338) and Eighth Circuit (*Foltz* v. *United States,* 458 F2d 600) hold that "an option in the lease to demolish the lessor's building precludes the taking of the deduction."

The above reference of the Sixth Circuit to the said holdings of the Fifth Circuit and Ninth Circuit is correct as far as it went, but should explain that in those cases the demolition loss deduction for the entire remaining unrecovered cost basis was permitted *in the year of demolition.*

The decision of the Seventh Circuit in *Landerman* is not actually a "split" with either of the above Fifth Circuit and Ninth Circuit decisions, because the facts differ. In *Landerman* the lessor received a valuable replacement building and so suffered no loss; *Landerman,* on its facts, is not authority for what it is cited by the Sixth Circuit in our case.

In *Foltz* the Eighth Circuit (again contra to the comment of the Sixth Circuit in our case) did permit the taxpayer to deduct the full amount of the demolition loss, though not in the year of demolition, but by "amortizing" the same amount over the term of the lease, in accordance with the pertinent Treasury Regulation.

In summary, *all* of the above cases permit the taxpayer (where the lease terms are similar to the instant case) to deduct the remaining unrecovered cost basis of the building where demolition occurs. None of these cases even suggest (as done in our case) that the mere inclusion of the permissive demolition clause in the lease was *proof* that the building was or became worthless when or because the lease was signed. Annual *depreciation deductions* (again contra to the holding in our case) were taken (and permitted as a matter of course by IRS) by taxpayer in all of the said cases up to the time of the building demolition.

The decision in our case is in sharp conflict with the above decisions in several aspects.

A) In our case and contra to the above holdings of four Circuits, both the District Court and the Court of Appeals (Appendix page A-24) adopted the wild statement of IRS counsel during trial — "No deduction if there is demolition clause" and considered the *mere inclusion* of the demolition clause as probative and damaging evidence against the Taxpayers.

B) In our case, again adopting another startling suggestion of IRS counsel at trial (fact that Taxpayers didn't try to break the lease *proves* that Taxpayers considered building to be worthless) both the District Court (Appendix pages A-11, 12) and the Court of Appeals (Appendix pages A-24, 25) considered

as probative and damaging evidence against the Taxpayers the mere fact that the Taxpayers abided by the terms of the lease (the same lease that was several times described as "IRONCLAD" by the same IRS counsel at the trial).

Under the present posture of our case, the IRS (most certainly in the Sixth Circuit) will improperly be justified in permitting or denying, at its uncontrolled whim, *any depreciation or demolition deduction* to any lessor of a lease giving such right of permissive demolition to a leasee. This will hold even where (as in our case) the demolition takes place some years after the lease was signed, and where lessee received substantial rental for said building until demolition and where Taxpayers (as in our case) did not originally enter into the lease, but inherited the lease, and where annual depreciation deduction (for about 5 years) had been allowed by IRS to the original lessor, for the *same building* and governed by the *exact same lease*.

Based on the above irreconcilable conflict between the several Circuits, there is bound to be a lack of the uniformity and a lack of the predictability to which taxpayers all over the country are entitled. This Court in this case should resolve this conflict.

Applicable in all respects to our case is the comment of Justice Douglas in his dissent in *Berenyi* v. *Immigration Director,* 385 U.S. 630, that the government's SKETCHY EVIDENCE there was dispelled by the overwhelming evidence contra, which evidence did in fact carry the burden of proof and the burden of persuasion, and that the concurrent findings of two lower Courts are not sacrosanct (citing *Graver Mfg. Co.* v. *Linde Co.,* 336 U.S. 271). OURS (too) IS SUCH A CASE!

CONCLUSION

For the reasons stated above, Taxpayers pray this Court to review and reverse the decision of the Sixth Circuit here, and so that the Taxpayers will get a fair and just adjudication of the *three issues* they submitted to District Court and to the Sixth Circuit, rather than only a Clearly Erroneous decision on the one issue (styled (a) Petition page 5).

Respectfully submitted,

WILLARD BARRY

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Cleveland, Ohio 44115

Counsel for Petitioners

APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

Civil Action No. C-70-137

WILLARD BARRY and HARRIET M. BARRY,
2501 Marlboro Road, Cleveland Heights, Ohio,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

FINDING FOR DEFENDANT

(Filed January 30, 1973)

(Pages 551 - 570 of Transcript)

[2] THE COURT: Everyone may be seated. I have determined to render my decision at the present time.

This is an action that the taxpayer brings to recover Federal Income Taxes paid under protest, I suppose you can say.

In any event, plaintiffs paid the taxes, and then thereafter bring this suit to recover taxes paid on certain items which go back to tax years 1959, 1960, 1961, 1962 — those four years. What about 1963 — or just through 1962?

MR. ROSS: Yes, your Honor.

THE COURT: We start out with the rule that is universally applied in suits to recover income taxes paid under Section 1346 of 28 U.S.C.

That rule is that the burden is on the taxpayers to prove that they are entitled to recover the taxes paid.

As the case developed there were a number of items upon which the parties reached a compromise in the course of this litigation, and as to those items, which may be referred to as stipulated items, [3] it is conceded by the Government, on the basis of those compromise settlements, if you will, that some recomputation is necessary and some recovery is necessary under the suit as brought.

We, however, deal here with the issue that has dominated this trial, and has certainly been recognized by the parties as the issue in the lawsuit; and that issue relates to the Colorado Springs property at 18-20 Tejon Street, in Colorado Springs, Colorado.

The evidence is clear that this property, which consisted of a parcel of land and a building, located within about a half a block of what is known as the 100 percent corner of Colorado Springs, was owned by Louie Mullin, the mother of Harriet Barry, one of the plaintiff taxpayers, at least as long as from the year of 1935 in her name, and apparently in the family from a period before that.

Mrs. Mullin died on June — or May 31 —

MR. BARRY: June 1st.

THE COURT: — on June 1st of 1959, and it is clear that Harriet Barry, under the applicable law, inherited the property upon the death of her mother. She inherited it of course [4] by reason of being a specific devisee in the will, the last will and testament of Mrs. Mullin.

I take up what I conclude finally, after giving this case considerable thought in the last few days, and after reviewing the evidence, and after hearing the helpful arguments

of counsel, is the central question that I must first decide and which may, depending on how I decide it, dispose of the lawsuit, and this is whether or not, on either June 1st, 1959, or June 1st, 1960, the building located on this property had a fair market value.

I therefore turn my attention to a review of the evidence on that point; and necessarily, under the general burden imposed on the plaintiffs, it is plaintiffs' burden to show that the building did have a fair market value on either June 1st, 1959, or June 1st, 1960, which was the alternate date that was chosen by the taxpayers under Section 1014 of Title 26 and the Regulations.

Plaintiff's evidence really comes down to the testimony of three witnesses, as I see it. With all due deference to the taxpayers and their testimony, I feel that I have to really decide whether or not they have sustained their burden [5] on the basis of the testimony of Mr. Laundy, and Mr. Parker, and Mr. Haigler.

The evidence does show that for Federal estate tax purposes the value of the Colorado Springs real property was valued, or was fixed at $160,000. This was determined by the federal estate agents of the Internal Revenue Service, and was accepted by the taxpayers.

Mr. Laundy testified, and Mr. Parker in similar approach, testified that in substance, that the normally accepted method for allocating values as between land and improvements is to use the tax value set up by the local assessing authorities, and just to interpolate the evidence here, it does indicate that for the years in question, and in fact for a number of years before, the assessor of El Paso County used, in this particular case on this particular parcel, an allcation of 60 percent for the land and 40 percent for the building.

Mr. Laundry was asked a hypothetical question which

included in part this allocation of the assessors of El Paso County, and he determined that the fair market value of this property, taking the $160,000 as the overall value of the [6] land and building, that in his opinion he finally said he would use 25 percent of $160,000

Mr. Laundry, of course, admittedly did not make the ordinary kind of real estate appraisal of this property. He is based in Cleveland, and he is a competent person, but he did not go to Colorado Springs, or if he did, it is not clear whether his experience here in Cleveland would justify him to make a normal, fair market value determination with reference to this property.

It is quite clear that he based his entire opinion upon two things:

One, the estate tax valuation of $160,000 on the property; and the assessor's use of the 40-60 ratio as between building and land.

On cross-examination he was asked a question in which, among other things, the reference was made to the existence of the lease and the right of the lessee to demolish the building.

He was asked, given those assumptions, "How much would you pay for the building," and he quite truthfully said, "Nothing, unless I could move it somewhere, and I don't think I could move this building."

[7] Giving his testimony the fullest weight possible, I am not persuaded that the formula approach that he took provides evidence or provides testimony that is sufficiently strong for me to hold that it sustained the burden that the plaintiff is required to sustain.

Similarly the testimony of Mr. Parker – again Mr. Parker is a man of great competence in the real estate law field here in Cleveland, and a person of fine reputation in every respect, and yet he was again basing his opinion on the

use of the assessor's breakdown of the value of the building and land; and when he was asked the question similar to that put to Mr. Laundy, he never quite answered the question. He said he would go to the bank and try to convince them there ought to be a better use for it; but he never quite answered the question, "How much would you pay for that building, given that lease, with the right of the bank to demolish?"

Similarly, therefore, I do not find that Mr. Parker's testimony, standing alone, or in conjunction with the other testimony, is enough to sustain the plaintiff's burden.

Mr. Haigler took a similar approach. He did [8] not make a market valuation in the usual sense, as I just reread his testimony He also, and in the final analysis, his testimony relied on the formula approach. He did go to the assessor's office and did note the 40 percent allocation to real property; and yet, as the record shows, Mr. Franson, the man who was responsible for making this breakdown, conceded that the formula that he used in arriving at those figures were pretty much a reproduction cost figure less depreciation.

It is evident that a fair market value approach as such was not at that time used, under Colorado law, or in the assessor's office, at least not in the assessor's office in El Paso County, Colorado.

Mr. Haigler — his cross-examination, really, I think, weakened any value that I could give, any probative value that I could give as to his opinion as to the value of the property.

Finally, under cross-examination, he was asked this question and gave this answer:

"Q How do you put 40 percent of the whole value of that prime downtown location on the building that only had five more years to have an [9] economically useful life?

"A Well, that was made more or less to the 1959 and 1960 estimate.

"Q Yes, sir; but I don't understand your answer.

"A I beg your pardon?

"Q I don't understand your answer.

"A Well, your question — would you repeat it again?"

And so it was repeated, and then he answered:

"A Well, that was just an estimate on my part. Maybe I was wrong. I don't know."

I go on, though, before I reach any final conclusion, to consider the other evidence in the record. The evidence as to the building shows that this building was built probably sometime before the turn of the century. Estimates range from 1885 to 1895, or even as late as 1900. The building is of stone and masonry construction, and it has a basement, and it is partly three floors and partly two floors.

The building does not have an elevator, and the evidence is undisputed that it could not [10] be air-conditioned. This came out in the testimony of Mr. Haigler, and it certainly also was brought out in the affidavit of Mr. Levy.

More or less summarizing the evidence relating to the building, it is evident, and I do find and conclude, that this building could not be used as a modern commercial retail establishment without extensive remodeling; in effect, rebuilding the building, and it is also clear on this record that it would have been quite expensive to have done that, and I believe Mr. Levy's statement that it was prohibitive is correct, and I do find that the building, really, as it stood, would have been so — would have cost so much money to have either rehabilitated it or remodeled it for modern retail use, that it could not be said that it really had a useful life left as a retail commercial structure in 1959.

I note that because of the building condition, as Mr. Leonard Owings brings out in his testimony – Mr. Owings having been chief building inspector during the period in question – and he says that the owners were told just not to use the upper floors. They weren't boarded up, [11] but they were just not allowed to use them, because of the violation of various building code requirements; and of course it is true, apparently, that the building was not used in those upper floors during those occupancies that are in evidence here.

The evidence further shows that for a number of years, certainly as early as 1940, when Owings' daughter worked for Woolworth's, the Woolworth Company occupied this property.

It appears sometime in the early 1950's it vacated the premises. The year 1952 has been suggested, and it may very well be that was the year.

In any event, thereafter it is clear, and I do find, that this building was vacant for several years, perhaps as many as three years. For all I know, two to three years may be about right; however, the first – except for the very short occupancy by Mr. John May, who used the building for exhibition purposes for perhaps a month or two months. It appears that the first lessee or renter of this property thereafter after Woolworth vacated was the Exchange National Bank of Colorado Springs.

[12] The Exchange National Bank entered a lease with Louie Mullin that gave it a five and five right of occupancy, five years beginning January 1, 1955, and the right to renew at the expiration of that first five-year period.

The Exchange National Bank, as such, never occupied the building. It is quite clear, both in the testimony of Mr. Ackerman and from the lease itself, that it was not within the contemplation of the Exchange National Bank

to use this property for anything other than for parking space, and this is understandable, because their bank was adjacent, and they needed parking facilities.

It is also clear from Mr. Ackerman's testimony that their long-range plans called for the establishment of a drive-in teller on this property; and of course eventually that is exactly what happened. Under a later lease a drive-in teller was installed or constructed on the property.

The evidence shows that the lease contained in Section 10 the right of the bank to demolish the building, and an earlier section of the lease indicated there were certain usual provisions with [13] reference to the maintenance of the building, but that earlier section — I think it was Section 3, said that it was subject to Section 10, which gave the bank the right to demolish.

It is quite evident that the Exchange National Bank would not have leased this property had it ever intended to use this building. It is, on the other hand, quite clear that it leased this property first for immediate parking space, assuming that this building would be demolished, and that is exactly what happened. They did lease the parking to a company by the name of Park-right, following the demolition of this building sometime in the fall of 1960.

So there is certainly nothing in the lease by the Exchange National Bank of this property that in any way supports the claims of the taxpayers that this building had a fair market value. On the contrary, it shows that the bank regarded the building as having no economic value.

Now, it does occur that for a period beginning in March of 1955, until December, 1956, the Exchange National Bank sublet the property to the First National Bank; and under the terms of that [14] sublease, the First National Bank paid this same amount of money that the Exchange National Bank was paying to the lessor owners. This of course is while Mrs. Mullin was still alive; but it appears

that the $13,000 annual rental, which included really $1,000 a month, plus $1,000 to apply on real estate taxes, was also the rental of the sublessee, the First National Bank.

This fact, however, does not offer the plaintiffs any proof that this property or this building had an economic value. It is quite clear that its occupancy, First National's occupancy, was entirely temporary. It was either remodeling or building a building or constructing a new one, I am not clear; but in any event, while it was in that process of readying another building for its continued use, it had no place to go, really, and apparently the only choice was a garage or something of that type; but here was this building available, and they apparently did spend some money — I think the suggestion was $25,000, according to Mr. Curry in temporarily readying this building for its temporary use.

[15] However, this was not the kind of capital investment that would indicate any belief that the building had an economic value, so that First National's use does not constitute evidence that this building had a useful life or further economic life.

Fashion Bar apparently subleased, first from First National Bank, and later directly from the Exchange National Bank, after the First National had vacated the property. It appears that the Fashion Bar remained there under their subleases until perhaps December of 1959, if I recall the evidence; however, when you consider all of the Fashion Bar's testimony that we have in this record, it would appear to me, and I do find, that undoubtedly they went in there thinking they may have a chance to enter into a long-term lease for this property, because there is no question but what this location is in a prime location for retail purposes; but I do think that the Fashion Bar testimony, taken as a whole, was that kind of a gamble that they hoped might pay off, but when it was evident apparently that the bank

was going to renew the lease, that ended any further negotiations [16] between Fashion Bar and the owner of the property, Mrs. Mullin, and then later in negotiations with Harriet Barry, her daughter and successor at interest.

So again, I don't feel that the Fashion Bar testimony offers the plaintiffs any proof that this property had a further effective life or further effective economic use.

As to the expert testimony offered by the defendant, the United States Government, we have of course the chart here sitting at the side of the courtroom, and in short, Mr. Curry, the expert, whom the Government called and qualified as a real estate appraisal expert in all respects, said that he had considered all three approaches.

It is true that at first he only mentioned two, but then he also indicated that he also considered the reproduction cost less depreciation approach, as well as the economic approach, as well as comparable sales; and his final conclusion was that this building really had a negative value, that it was a burden on the land, and a detriment rather than a benefit, and as his chart shows here, which is in evidence, he [17] estimated the value of the property at $161,500; whereas — which would be, if you apply a 6 percent return to that — produce income of $9,690; whereas, the net income under the lease, assuming the building was being used, realized a figure of $8,800, and thus you have a loss as between the two income figures.

Mr. Curry also finally testified as to what he thought was the highest and best use for this property, which I think is certainly an important factor in determining whether the building has an economic use, and his testimony went something like this:

His strong opinion was that with the old building on it, that this would not be the highest and best use. He further stated that it was his opinion that it was not

potentially feasible to remodel that building. He felt that the highest and best use was either as a parking lot, or with the old building torn down and a new building built in its place. Certainly, Mr. Curry's testimony does not support the plaintiff's position.

There is one other aspect of the testimony that I think has some bearing, and certainly isn't [18] more than one aspect of the testimony, but it does have some bearing in evaluating the plaintiff's position.

On all the evidence I am convinced, and I find, that in some manner, before that building was demolished, and before demolition was undertaken, the taxpayers learned that demolition was contemplated.

I think, if nothing else, they certainly were apprised that that was clearly in the wind when they received this communication in August requesting title of the property; and as I look at that attachment, I realize again something I perhaps had forgotten; that Colorado is under the Torrens Title, and apparently this is a Torrens Title attachment.

In any event, this becomes significant. At first I didn't get what this was all about, until, really, considering the case in chambers.

It is true that as a legal proposition, as Mr Barry testified, he talked with a lawyer and reached a legal judgment that there was nothing that the taxpayers could do to prevent the, directly prevent — put it that way — the bank from demolishing that building under the firm [19] right given it by Section 10 of the lease; however, it is also true under that lease that the bank could not sublet without approval of the lessor; and I think it is pretty clear that the bank would not have gone ahead with the demolition of that building had it not been able to immediately undertake an arrangement or enter into a sublease with Parkright, the parking lot company.

You can see how the bank thinks. When it wasn't occupying the property, it wanted to be perfectly sure it wasn't losing on this; so they got the First National Bank first, and then Fashion Bar, in effect, to pay them the same amount of money that was charged under lease; and so here I don't think they would have gone ahead with the demolition of that building without intending to immediately use it for parking lot purposes; and it is clear, therefore, that they had to get consent from the taxpayers before subletting it to Park-right under that lease.

So had the taxpayers really, deep down in their hearts, believed that that building should not have been torn down, and that it did have an economic value that they wanted to save, I think [20] they could have asserted their right to not consent to that.

Now, I grant you it would have been an indirect way to try to stop it, but at least it has some little bearing on this case — not much. I don't give it great weight, but I do mention it in passing.

However, upon all the evidence, which I have not attempted to completely analyze, but have attempted to at least summarize the highlights, I do find and determine that the plaintiffs have failed to sustain the burden imposed upon them to show that this building had a fair market value on either June 1st, 1959, the date of Mrs. Mullin's death, and the date that Harriet Barry inherited the property, or on the alternate date of June 1, 1960, one year later.

On the contrary, the evidence shows, and I find, that the value of $160,000 fixed for federal inheritance tax purposes is attributable solely to the land.

Having reached this conclusion, it is unnecessary to consider, and I do not decide the applicable law in connection

with the plaintiff's claim of a demolition loss of some $31,875, the [21] claimed unrecovered basis of the building.

In other words, I do not find it necessary to determine whether to follow Feldman, 335 Fed. 2d, 264, Ninth Circuit, 1964, and the cases that followed Feldman; or Landerman, 454 Fed. 2d, 338, Seventh Circuit, 1971, and the cases that have followed Landerman; insofar as these cases have interpreted the meaning of the term "pursuant to the requirements of the lease," as found in regulations 1.165-3 (b) (2).

Further, having determined that this building had no fair market value, I further find and conclude that the taxpayers had no depreciable interest in the building, and therefore the taxpayers could not, under Section 167, claim depreciation in either 1959 or 1960.

With reference to the foregoing issues, judgment is rendered for the Government; however, as to the stipulated items previously mentioned, judgment is entered for the taxpayers.

It is so ordered. Exceptions of course are noted to the Plaintiffs.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

Civil Action No. C-70-137

WILLARD BARRY and HARRIET M. BARRY,
2501 Marlboro Road, Cleveland Heights, Ohio,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

ORDER

(Filed January 31, 1973)

Rendering its oral opinion in open court on January 30, 1973 and repeating here only as to what follows:

The Court finds and determines that the plaintiffs have failed to sustain the burden of proof imposed upon them to show that this building had a fair market value on either June 1, 1959, the date Mrs. Mullin died, and the date that Harriet Barry inherited the property, or on the alternate date of June 1, 1960, one year later.

On the contrary, the evidence shows, and the Court finds, that the value of $160,000.00 fixed for Federal Inheritance Tax purposes is attributable solely to the land.

Further, having determined that this building had no fair market value, I further find and conclude that the taxpayers had no depreciable interest in the building, and therefore the taxpayers could not, under section 167, claim depreciation in either 1959 or 1960.

With reference to the forgoing issues, judgment is rendered for the Government, however, as to the stipulated items previously mentioned, judgment is entered for the taxpayers.

IT IS SO ORDERED:

/s/ WILLIAM K. THOMAS
U.S.D.C. Judge

No. 73-1858

UNITED STATES COURT OF APPEALS
For the Sixth Circuit

WILLARD BARRY and HARRIET BARRY, *Plaintiffs-Appellants,* v. UNITED STATES OF AMERICA, *Defendant-Appellee.*	APPEAL from the United States District Court for the Northern District of Ohio.

Decided and Filed August 5, 1974.

Before: WEICK, McCREE and ENGEL, Circuit Judges.

ENGEL, Circuit Judge. Taxpayers Willard Barry and his wife Harriet M. Barry appeal from that part of a judgment of the United States District Court for the Northern District of Ohio which denied their claim for a refund of income taxes based upon claimed depreciation for the years 1959 and 1960 and upon a claimed loss resulting from demoli-

tion in 1960. The taxpayers had sought unsuccessfully to take depreciation in those years on a commercial building owned by them and located in downtown Colorado Springs, Colorado. They were likewise unsucessful in claiming a loss due to demolition when the building was torn down.[1] Harriet Barry had inherited the property by specific devise from her mother Louie N. Mullin when she died on June 1, 1959.

The district court found that all of the value in the Colorado Springs property lay in the land, and that the aging commercial building located upon it was without a separate market value. Consequently, the judge ruled that the building was without separate adjusted basis, within the meaning of § 1014 of the Internal Revenue Code of 1954, from which taxpayers could take depreciation under § 167 or a demolition loss deduction under § 165.[2]

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[1] It is the position of the taxpayers that the building should have been valued for purposes of deducting depreciation in their 1959 and 1960 income tax returns at $40,000, that depreciation on a ten year straight line basis should accordingly have been allowed in the amount of $2,333 for seven months and $3,500 for the ten and one-half months in 1960. They further claim that they were entitled to take a remaining unrecovered cost basis of $34,167 as a loss within the meaning of § 165 of the Internal Revenue Code of 1954, as such loss is further defined in Treasury Regulations § 1.165-3.

[2] Pertinent sections of the Internal Revenue Code of 1954 as applicable to this case are as follows:

SEC. 165. LOSSES.

(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) *Amount of deduction.*—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

SEC. 167. DEPRECIATION

(a) *General Rule.*—There shall be allowed as a depreci-

The principal issue on appeal is whether the district court correctly determined that the building for which taxpayers claimed depreciation and demolition loss had no value, and therefore afforded taxpayers no basis from which to depreciate or suffer a loss due to demolition.

A taxpayer's basis in inherited property is the fair market value of that property at the date of decedent's death or, at the taxpayer's option, at the "alternate valuation date".

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ation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or
(2) of property held for the production of income.

* * *

(g) *Basis for depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

SEC. 1011. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter) and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses), adjusted as provided in Section 1016.

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) *In general.*—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

§§ 1014, 1032, Internal Revenue Code. For purposes of federal estate tax liability, the Barrys elected to take their basis as of the alternate valuation date of June 1, 1960. At that time, it was agreed that the total value of the taxpayers' Colorado Springs real estate was $160,000. However, no breakdown or allocation between land or building was made on the estate tax return. Thus, while the total value of the property is not seriously disputed in this action, for the purpose of assessing the amount, if any, of depreciation and loss deductions allowable to the taxpayers for the building, it was incumbent upon the taxpayer, the Internal Revenue Service, and ultimately the trial court to make a determination of the taxpayers' basis in the building, by allocating the total fair market value of the property between the land and the building.

"Fair market value of property" has been defined as "what a willing buyer would pay to a willing seller". *United States* v. *Miller,* 317 U.S. 369 (1943). Likewise, this court has held that the determination of fair market value is a question of fact. *Estate of Kreis* v. *C.I.R.,* 227 F 2d 753 (6th Cir. 1955). Findings of fact may not, of course, be set aside unless they are clearly erroneous. F.R.Civ.P. 52. Thus, while the facts may be complex and the possible inferences therefrom various, the function of this court is a narrow one — to decide whether the trial court's finding that the building owned by the Barrys had no value — i.e. no fair market value — was clearly erroneous.

Taxpayers' Colorado Springs property had been in Mrs. Barry's family for many years. The exact date of the construction of the building was never accurately established, but the proofs showed that it predated the turn of the century. Basically, the structure was a part two-story and part three-story building, of stone and masonry construction, which occupied all of a lot located at 18-20 South Tejon

Street in downtown Colorado Springs. The lot itself was 190 feet in depth, and its 50 foot frontage on South Tejon Street lay some 200 feet south of the intersection of South Tejon and Pikes Peak Avenue, generally recognized as the commercial center of Colorado Springs. While there was a dispute of fact concerning the structural soundness of the building, the proofs supported the finding of the trial court that the building was without an elevator, could not be air-conditioned, and that, in fact, the owners were instructed not to use the upper floors because of non-conformity with various building code requirements.

Louie N. Mullin owned the property until her death on June 1, 1959, at which time she was a resident of Ohio. On September 15, 1954, Mrs. Mullin had entered into a lease of the premises with the Exchange National Bank of Colorado Springs as lessee. The original term of the lease was five years, commencing January of 1955, with an option in the lessee to extend the lease for an additional five years, until January 1, 1965. The lease also gave to the lessee the option at any time during the lease term to demolish the building with no payment required to be made on that account to Mrs. Mullin as lessor. The lease did not, however, require demolition. The lease provided that the Exchange National Bank was to pay a monthly rental of $1,000 and an annual payment of $1,000 toward real property taxes. It placed as conditions on the exercise of the demolition option only that the lessee give prior notification to the lessor by registered mail, and that demolition be done in a good and workmanlike manner at lessee's expense. The lease did not require the construction of any building in place of the demolished building.

On April 23, 1959, the Exchange National Bank exercised its option to extend the lease for the additional five years. In August of 1960, more than one year after Mrs.

Mullin's death, the bank exercised its additional option to demolish the building. Demolition was completed by November 15, 1960.

The evidence in the case supported the finding of the trial judge that Exchange National Bank's purpose in entering into the lease in 1954 and exercising its option to renew in 1959 was not to occupy the building as such, but was to retain its possession of the land so that ultimately it could be used for a parking lot and a drive-in teller facility. The property was eventually put to such use under a later lease. Meanwhile, to recoup its rental expenses, the Exchange National Bank put the building to other uses. From March 1955 through December 1956, the building was sublet to the First National Bank at an annual rent of $13,000, the exact amount of Exchange National Bank's annual obligation to the lessor. First National spent $25,000 in improvements on the building for use as a temporary main office in downtown Colorado Springs while it was rebuilding its own building. Thereafter, the building was subleased to Fashion Bar, a women's clothing store which had been required to vacate its prior location because of an expansion of a J. C. Penney Company building. Fashion Bar occupied the premises at the time of Mrs. Mullin's death and thereafter until December of 1959 when it moved to a building which it had purchased.

By the time the dispute came to trial, the building had been gone for more than twelve years, which made valuation more difficult. Nevertheless, the parties presented to the court what we consider to be a classic factual dispute over value which was ultimately resolved by the trial judge adversely to the taxpayers. In addition to the evidence discussed above relating to the uses of the building, the trial court received a wide variety of evidence both from

taxpayers and the government on the issue of the fair market value of the building in 1959 and 1960.

Taxpayers offered evidence of value which directly or inferentially might have supported a separate valuation of the building at an amount ranging from $45,000 to $72,680. Their proofs included an appraisal for insurance purposes at $72,680; evidence that fire insurance in force at the date of death and demolition was carried in the amount of $60,000; evidence that the El Paso County Assessor's Office allocated the total value of the property at 40% for the building and 60% for the land; and their own income tax returns for 1959 and 1960 which placed a value on the building at $54,000 which they later amended to $45,000. In addition, Mrs. Barry testified as owner of the property that, in her opinion, the building had a value of $60,000 and a remaining useful life of 20 years. The trial judge placed little or no reliance on Mrs. Barry's own valuation. He also gave little credence to the 60/40 allocation of the assessor's office, as the proofs showed that it was a standard formula and was not based upon an appraisal of actual fair market value of the particular property in question.

In our view, the most compelling evidence in favor of the taxpayers was the proof that on the date of Mrs. Mullin's death, the store was actually in use as a dress shop and the lessee was actually paying the sum of $1,000 per month in rent and $1,000 per year toward taxes. Thus, argue the taxpayers, any structure which has a use value of at least $1,000 a month must have a fair market value in addition to the value of the land on which it is located.

The trial judge, however, rejected the evidence of the plaintiffs below in favor of what the taxpayers have in their brief characterized as a:

> "1972 hypothetical appraisal of the building . . . by Albert Curry, paid professional 'expert' witness who had never inspected the building . . . [whose] appraisal was based upon prices paid for the acquisition of 5 other downtown real estate parcels, admittedly acquired for development, with no value attributed by Curry to any of the buildings on the acquired parcels, and with no details furnished as to income and expense data for the acquired buildings; so that none of said other buildings was fairly comparable to the building in question."

Accordingly, appellants urge us to hold that the trial judge's findings based upon the expert's testimony are clearly erroneous.

We disagree with the appellants' characterization of the government's proof of value. The trial judge's decision did not rest on so slender a reed as appellants suggest. While it is true that the appraisal by the government's expert was not made until years after the demolition of the building, the appraiser demonstrated that he was exceedingly well qualified and familiar with commercial values of downtown property in Colorado Springs at the times involved.[3] He properly analyzed the value of the subject property from the three traditional approaches[4] and he satisfactorily explained why he rejected the "reproduction costs less accrued depreciation" approach to value

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[3] Mr. Curry explained to the court that he had researched the records of the Assessor of El Paso County, which included information as to construction, condition and other factors of the building and other buildings in the area, and also that he talked to individuals who were knowledgeable as to the buildings at the particular time. Mr. Curry's qualifications as an expert real estate appraiser were also fully established in court.

[4] Mr. Curry testified that the three traditional approaches are (1) cost less depreciation, (2) market data, and (3) the income approach.

for this building,[5] and accepted as most accurate the results reached by use of market data and income analysis.[6]

The government's expert witness, Mr. Curry, testified that on the date of inheritance, as well as on the alternate valuation date, the highest and best use of the property was either as vacant land suitable for parking, or suitable and available for the construction of a new commercial building. He further testified and the trial judge accepted his opinion that the old building was a detriment to the overall value of the property. Contrary to the assertion of appellants, the other downtown real estate sales investigated and

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[5] According to Mr. Curry, reproduction cost less accrued depreciation was not an appropriate approach for estimating value in the case of a building over sixty years old.

[6] Mr. Curry explained his conclusions based upon the income and market data approach, as follows:

> "I indicated earlier, in order for the building to have value, the property had to be capable of producing enough net income that a return or market rent on the value of the land has to be deducted first, and then any income that remains is attributable to or computable to the building, and by taking this figure and capitalizing it at a rate, it gives an indication of building value, so the next step here was to subtract from this net income a return, and I used the rate of 6 percent as being a minimum return that one would expect on their investment at this time at the date of valuation, so I deducted from this 6 percent interest or income return on the land value of $161,000, which I had estimated based on the market data.
>
> "We see if we multiply the $161,000 by 6 percent, and as representing the interest or economic rent return on the value of the land as though vacant, would require an income of $9,690."

Having demonstrated earlier in his testimony that the land with the building on it was capable of producing $8,800 in income, Mr. Curry concluded:

> ". . . as so improved, the building has no market value at all; but, rather, it has become a detriment to the land, and really it should have been torn down, because it is incapable of producing net income imputable to improvements; in fact, there is some $890 short because the building is there."

relied upon by the government expert as comparables, provided convincing support, not only for Mr. Curry's valuation of the property as a whole, but for his conclusion that the entire value of it lay in the land.

Neither do we find merit in appellants' assertion that the government's case rested solely upon expert testimony and was, therefore, deficient. Appellants cite in this regard *Estate of Kreis* v. *Commissioner, supra.* In *Kreis,* this court held that the testimony of an expert, alone, was insufficient to compel reversal when the expert's findings conflicted with the findings made by the trial court. *Kreis* is authority for affirming the decision of a trial court when its findings are not clearly erroneous. In so holding, this court noted that the trial judge was not bound to accept the findings of an expert, but *Kreis* did not hold that he was bound to reject them, even as the sole basis for his decision. In any event, the trial judge in this case had additional evidence before him against which to measure that opinion testimony. He had the facts as testified to by the manager of the Fashion Bar, Mr. Levy, relating to the condition of the building at the time. Most importantly, the trial judge had before him evidence of the contemporary treatment of the property at the times involved by those having the responsibility to deal with it, the officers of the Exchange National Bank, Mrs. Mullin, and the taxpayers themselves. This included, of course, the willingness of the Exchange National Bank to rent the property and to take the risk that it might not be able to recoup its rents, solely for the purpose of retaining a right to demolish the building and to use the resultant vacant land for parking. Also convincing to the trial judge and to us was Mrs. Mullin's willing and presumably well informed decision to enter into a relatively short term lease, which, nevertheless, gave to the lessee a right to

demolish the building altogether, without any further compensation.

While taxpayers strenuously urge to the contrary, it was permissible for the trial judge to infer from the proofs that taxpayers themselves, in failing to take any steps to avert the demolition of the building, at least in part, tacitly acknowledged that it had little value apart from the land.

Although, as we noted earlier, taxpayers' proof that the building was rented at the date of death was their most convincing evidence of its value, we do not believe it sufficient to render clearly erroneous the trial judge's finding of no fair market value. Indeed, a close examination of the record and the trial judge's expressed reasons for his findings, reveal sound reasons for disregarding this evidence as controlling proof of value.

It is undisputed that, even with the building, the property had value and was capable of use. We do not believe that it necessarily follows, however, as urged by appellants, that for this reason a failure to ascribe any market value to the building itself was error. Upon reviewing the condition of the building and concluding that rehabilitation costs were prohibitive, the judge concluded that "It could not be said that it really had a useful life left as a retail commercial structure in 1959." He further concluded that the bank itself, in leasing the property, "regarded the building as having no economic value", and that the decision of the Fashion Bar to locate in the building and later to seek unsuccessfully a lease in its own right, was in recognition of the prime location which was offered, not of the value of the building itself, and reflected its willingness to take a gamble that it might acquire that location for its own later use.

Moreover, we find no merit in the contention of the taxpayers that the trial court gave no weight to certain evi-

dence offered by them and received by the court.[7] Appellants do not assert that any evidence which they offered was erroneously excluded from presentation or consideration. It is the function of the trial court alone to weigh evidence and assess credibility of witnesses. As taxpayers themselves argue, even the testimony of an expert witness may be disregarded if it conflicts with the sound judgment of the trial court based on his evaluation of all the evidence. *Estate of Kreis* v. *C.I.R., supra.* The reviewing court is not to substitute its judgment on the probative value of specific evidence, but is to look to the entire evidence on the record. Unless, on that basis, it is "left with a definite and firm conviction that a mistake has been committed", it must affirm the findings of the trial court. *Commissioner* v. *Duberstein,* 363 U.S. 278, 291 (1960).

We conclude, therefore, upon a careful review of the entire record, that the finding of the district court that the building had no fair market value on the dates in question, and hence that appellants had no basis in the building, is supported by the competent evidence, and is not clearly erroneous. F.R.Civ.P. 52. We decline to hold that, as a matter of law, a building must have a separate fair market value, as that term is defined in *United States* v. *Miller, supra,* whenever it has a rental value, however temporary.

Finally, we conclude that the district court was correct in declining to consider whether, because of a demolition clause in the lease, taxpayers would have been precluded by Section 1.165-3 (b) (2) of the Treasury Regulations to the Internal Revenue Code from taking a demolition loss

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[7] Appellants assert that the trial court accorded "no weight" to: the testimony of either taxpayer; the testimony of the official from the county assessor's office; the evidence regarding fire insurance; evidence of rental use; and the evidence of value as detrmined by the Colorado Department of Revenue.

deduction under Section 165 of the Code.[8] The lease granted the lessee an option to demolish the building, but did not mandate it. Since the trial court found as a matter of fact that the building had no fair market value and hence no separate adjusted basis, a finding which we hold to be not clearly erroneous, it treated the issue as moot. We agree. Even under the construction of the law urged by taxpayers,[9] there would be no loss to deduct since the adjusted basis of the building was found to be zero. "A court is not empowered to 'declare for the government of future cases, principles of law which cannot affect the result as to the thing in issue in the case before it'." *Caldwell* v. *Craighead*, 432 F 2d 213, 218 (6th Cir. 1970).

Accordingly, the judgment of the district court is affirmed. Costs to appellee.

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[8] United States Treasury Regulation § 1.165-3(b)(2) provides:

> If a lessor or lessee of real property demolishes the buildings situated thereon pursuant to the requirements of a lease or the requirements of an agreement which resulted in a lease, no deduction shall be allowed to the lessor under Section 165(a) on account of the demolition of the old buildings.
>
> • • •

Whether this language prohibits a demolition loss deduction where demolition is not actually mandatory, but is nevertheless permitted by the lessee during the term of the lease, has produced a split in the circuits. The Seventh Circuit in *Landerman* v. *Commissioner*, 454 F 2d 338 (1971), and the Eighth Circuit in *Foltz* v. *United States*, 458 F 2d 600 (1972), have taken the position that an option in the lessee to demolish the lessor's building, precludes the taking of the deduction. The Ninth Circuit in *Feldman* v. *Wood*, 335 F 2d 264 (1964), and the Fifth Circuit in *Hightower* v. *United States*, 463 F 2d 182 (1972), take a more restrictive view of the regulatory language, holding that the lessor may take the demolition loss where demolition by the lessee is of rental use; and the evidence of value as determined by the Colorado permitted but is not mandatory under the terms of the lease. As the issue is not properly before us, we can not take a position at this time as to the proper construction of the regulation. We note, however, that the pertinent regulation is currently under study for possible amendment.

[9] See *Feldman, supra*, and *Hightower, supra*.

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 73-1858

WILLARD BARRY AND HARRIET BARRY,
Plaintiffs-Appellants,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellee.

JUDGMENT

(Filed August 5, 1974)

Before: WEICK, McCREE and ENGEL, Circuit Judges.

APPEAL from the United States District Court for the Northern District of Ohio.

THIS CAUSE came on to be heard on the record from the United States District Court for the Northern District of Ohio and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby affirmed.

It is further ordered that Defendant-appellee recover from Plaintiffs-Appellants, the costs on appeal, as itemized below, and that execution therefor issue out of said District Court.

ENTERED BY ORDER OF THE COURT

/s/ JOHN P. HEHMAN
Clerk

TREASURY REGULATIONS

§ 1.165-3 DEMOLITION OF BUILDINGS.—(a) *Intent to demolish at time of purchase.*—(1) * * *

(2) (i) If the property is purchased with the intention of demolishing the buildings and the buildings are used in a trade or business or held for the production of income before their demolition, a portion of the basis of the property may be allocated to such buildings and depreciated over the period during which they are so used or held. The fact that the taxpayer intends to demolish the buildings shall be taken into account in making the apportionment of basis between the land and buildings under § 1.167 (a)-5. In any event, the portion of the purchase price which may be allocated to the buildings shall not exceed the present value of the right to receive rentals from the buildings over the period of their intended use. The present value of such rights shall be determined at the time that the buildings are first used in the trade or business or first held for the production of income. If the taxpayer does not rent the buildings, but uses them in his own trade or business or in the production of his income, the present value of such right shall be determined by reference to the rentals which could be realized during such period of intended use. The fact that the taxpayer intends to rent or use the buildings for a limited period before their demolition shall also be taken into account in computing the useful life in accordance with paragraph (b) of § 1.167 (a)-1.

(ii) * * * and any portion of the basis of the buildings which has not been recovered through depreciation or otherwise at the time of the demolition of the buildings is allowable as a deduction under section 165.

(iii) The application of this subparagraph may be illustrated by the following example:

Example. In January 1958, A purchased land and a building for $60,000 with the intention of demolishing the building. In the following April, A concludes that he will be unable to commence the construction of a proposed new building for a period of more than 3 years Accordingly, on June 1, 1958, he leased the building for a period of 3 years at an annual rental of $1,200. A intends to demolish the building upon expiration of the lease. A may allocate a portion of the $60,000 basis of the property to the building to be depreciated over a 3-year period. That portion is equal to the present value of the right to receive $3,600 (3 times $1,200). Assuming that the present value of that right determined as of June 1, 1958, is $2,850, A may allocate that amount to the building and, if A files his return on the basis of a taxable year ending May 31, 1959, A may take a depreciation deduction with respect to such building of $950 for such taxable year. The basis of the land to A as determined under sub-paragraph (1) of this paragraph is reduced by $2,850. If on June 1, 1960, A ceases to rent the building and demolishes it, the balance of the undepreciated portion allocated to the buildings, $950, may be deducted from gross income under section 165.

* * *

(b) *Intent to demolish formed subsequent to the time of acquisition.*—(1) Except as provided in subparagraph (2) of this paragraph, the loss incurred in a trade or business or in a transaction entered into for profit and arising from a demolition of old buildings shall be allowed as a deduction under section 165 (a) if the demolition occurs as a result of a plan formed subsequent to the acquisition of the buildings demolished. * * *

(2) If a lessor or lessee of real property demolishes the buildings situated thereon pursuant to the requirements of a lease or the requirements of an agreement which resulted in a lease, no deduction shall be allowed to the lessor under section 165(a) on account of the demolition of the old buildings. However, the adjusted basis of the demolished buildings, increased by the net cost of demolition or decreased by the net proceeds from demolition, shall be considered as a part of the cost of the lease to be amortized over the term thereof.

* * *

§ 1.167(f)-1 Basis for Depreciation. The basis upon which the allowance for depreciation is to be computed with respect to any property shall be the adjusted basis provided in section 1011 for the purpose of determining gain on the sale or other disposition of such property. . . .

* * *

§ 1.1001-1 Computation of gain or loss

(a) General rule . . . . The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. . . .

* * *

EXCERPTS FROM TESTIMONY OF IRS EXPERT CURRY

TESTIMONY OF JAMES CURRY

DIRECT EXAMINATION

* * *

Q What investigation did you make to learn about the building as of the date of June 1, 1960?

A The building is not existing any more. My investigation included research of the records of the Assessor of El Paso County. These records do include information as to the construction and general condition, age and what not, of the building, of the buildings that did exist in the City; and I also talked to individuals who were knowledgeable as to the buildings at that particular time, and also read the depositions which were taken from these people having to do with this condition of the building.

Q Can you describe what the building looked like in 1960, before it was demolished?

A My investigation, relying on these sources, and all indicated that it was —

* * *

Q Your question was; what steps are taken?

A The steps, the methodology for making this estimate that is accepted as the proper appraisal methodology is to examine the income which this property is capable of producing for the building itself to have a market value as a part of the total market value of the property. This property, as improved with that building, must be capable of being rented in the market for an amount which will

result in a net income greater than the economic rental value of the land as though it were vacant.

* * *

Q Mr. Curry, how did you arrive at a fair market value for the land alone?

A That is the first step in this procedure, and I arrived at this by examining the sale and compared it to other transactions relating to land in the downtown area of Colorado Springs at the date of valuation or close thereto.

* * *

A * * * that site sold at the unit price of $22 per square foot, including the old building.

* * *

A * * * The site sold for $13.75 per square foot.

* * *

A * * * It sold at the unit price of $12.63 per square foot of land, to include the old building.

* * *

A * * * It was also razed as a part of a redevelopment, and it sold at $12.20 per square foot.

* * *

A * * * and a total area of 18,050 feet, with a two-story building, with one of the last occupancies being a restaurant; and it sold at $10.95 a square foot.

* * *

A * * * it contains a total area of 18,925 square feet, to indicate a unit sale price of $18.45 per square foot of land.

* * *

These sum transactions in summary shows 51,000 square

feet of land having been acquired for $18.38 a square foot, and that indicates the subject land has a greater value.

* * *

So my conclusion is from analysis of these, that the subject property then would have an indicated value of $17.00 a square foot, as of the date of valuation in 1960, or the total property of land value of $161,500 would be my conclusion, * * *

* * *

Q What was your next step in arriving at the fair market value alone?

A I indicated earlier, in order for the building to have value, the property had to be capable of producing enough net income that a return or market rent on the value of the land has to be deducted first, and then any income that remains attributable to or computable to the building, and by taking this figure and capitalizing it at a rate, it gives an indication of building value, so the next step here was to subtract from ths net income a return, and I used the rate of 6 percent as being a minimum return that one would expect on their investment at this time at the date of valuation, so I deducted from this 6 percent interest or income return on the land value of $161,000, which I had estimated based on the market data.

We see if we multiply the $161,500 by 6 percent, and as representing the interest or economic rent return on the value of the land as though vacant, would require an income of $9,690.

That amount is less than the income for the property that the property was capable of producing with the building on it, so it is my conclusion then that all of the land has this value, that as so improved, the building has no market value at all; but, rather, it has become a detriment

to the land, and really it should have been torn down, because it is incapable of producing net income imputable to improvements; in fact, there is some $890 short because the building is there.

STATEMENT BY MR. DuLAURENCE, ATTORNEY FOR PLAINTIFFS

MR. DuLAURENCE: The trouble with the finding as it is at the present time is that there is one very large assumption, and that is that you can get $13,000 for the land that is vacant, and that you can get it over a period of time.

Now, this is purely an assumption.

CROSS EXAMINATION

BY MR. BARRY:

Now, with reference to this that you designated as Sale No. 1, a month before than, such as November of 1955 — describe that. Do you have a picture of the building?

A No, sir. I don't have a picture.

Q Did you ever see it?

A Yes.

Q Describe the building. How much floor does it have?

• • •

Q Did you ever actually see it?

A Yes, sir.

Q How many stories?

A That building — I don't remember exactly from having seen it that it had — but I had researched the records as to what was there, and it indicates that it was a one-story building.

Q What did it indicate whether or not it had a basement?

A I didn't make any note of it in these notes. I didn't inquire.

Q Now, in this period of a year before the sale, what was the occupancy and income for the owner?

A I don't know the answer to that.

Q All right. In the period of the year before the sale, what was the real estate tax based upon, the assessed value for the building?

A I don't know.

Q What was the fire insurance coverage a month before the sale?

A I don't know that.

* * *

Sale No. 2, April, 1956, 25 North Cascade. Tell us about that. Do you have a picture of that building?

A No.

Q Did you ever see it?

A Yes.

Q Tell us about it.

A On the same basis that I saw the other ones.

Q Someone told you something?

A No, sir. I went to the assessor's and examined what was there.

Q All right.

And what did the Assessor show for the year 1956 — what did the Assessor show the ratio to the building?

Q You didn't check that?

A I didn't pay any attention to it.

* * *

Q For the year before April of 1956, who were the one or more occupying tenants of that property?

A My investigation revealed the last tenants were Coca-Cola.

Q What was their rent per month?

A I don't know.

Q Do you know what the fire insurance coverage was on that building, placed by the owner?

A No, sir.

* * *

Now, Sale No. 3, December, 1955. Do you have a picture of that?

A No, sir.

Q Did you ever see a picture of it?

A I think there is a picture of it in the records of the Assessor's.

Q Were you ever in the building?

A Yes.

Q Describe it. Tell us about it. How many stories does it have?

A Accordingly, again refreshing my memory from the Assessor's records, it was a two-story masonry building.

Q And on the Assessor's records what was the valuation for the year 1955.

A I don't know.

Q Do you know what the ratio was between the building and land?

A No.

Q Do you know how much fire insurance was in force by the owner on that building at the time it was sold?

A No, sir.

* * *

Q Sale No. 4, August 1956. Tell us about that. Have you got a picture of that?

A I do not have, no, sir.

Q Tell us about it. How many stories was it?

A According to this record, it was a two-story building.

* * *

Q And prior to the sale and at the time of the sale, tell us if there was a tenant in there.

A I don't know for sure.

Q So you wouldn't know how much the rent was?

A No sir, if any.

Q On the records of the County Assessor's, El Paso County, of 1956, the one you have as Sale No. 1, what is that listed at for real estate tax purposes as of that date?

A I don't know.

Q Do you know the ratio between the building and land?

A No.

Q Do you know what the fire and extended hazard insurance was that was in force on that building at that date?

A No, sir.

Q Sale No. 5; describe that building at the date of the sale, from what you know. What did you know personally about it?

A I know by reviewing the records of the El Paso County Assessor's Office.

Q What kind of building was it?

A The building was a two-story masonry building, and it had a restaurant shown as the occupant in the lower level, and other tenants unknown.

Q What was the gross rental to the owner?

A I don't know.

Q Do you know on July, 1958, do you know what the fire insurance was that was in force?

A No.

Q Do you know what the building was assessed for for real estate taxes?

A I didn't look.

Q So you wouldn't know what the ratio was as between the building and land?

A No, sir.

Q Sale No. 6, April, 1956; did you ever see that building?

A There is no building there.

Q That was a vacant lot?

A Yes.

* * *

Now, having reference to that time when this First National Bank was in there, and this was their main operation, and they were paying $13,000 a year; is it your estimate during that period of time that this building had no value?

A My estimate that the building had no market value is a part of the total property. I just happened to use it that way.

* * *

A It is my opinion that the building did not have value, market value. The building did not have market value.

Q And this has reference to a time when the First National Bank was operating their main office in there?

A The fact that it is usable doesn't give it market value.

THE COURT: I didn't understand that.

A (Continuing) The fact that it was partially usable did not, in itself, in my judgment, make it have market value as a part of the whole property.

Could I explain further?

Q Yes. I would like to hear your explanation.

A My position is that the property, including the time when the First National Bank was the sublessee would have sold for at least as much without the building, perhaps more, as it would have with the building; and the building itself did not have market value as a part of the total property. The land had a value, but not the building.

Q And the fact that a tenant is willing to pay $13,000 for the use of the building doesn't alter your opinion in any way?

* * *

A No, sir. My answer is no.

* * *

Q Is your answer the same with reference to the use of the building, the fact that they were there using the building as a retail store? I am referring now to Fashion Bar, and paying –

A My answer remains the same.

Q – and paying roughly $1,000 a month; and your statement is that during that period it is your opinion that the building had no value?

A The building has no market value.

* * *

Q So on this basis – that the payment of $13,000, and the net of $8,500, and using a 6 percent interest, keeping in mind that the First National Bank is using only the building, can you compute or estimate what, on that net income basis, capitalized, what the value of that building would be?

A I have attempted to explain –

Q I don't want you to explain.

A There is none.

* * *

Q Now, keeping in mind the payment of about $50,000 to the Exchange National Bank for different subtenants

during the years 1955, 1956, 1957, 1958 and 1959, who used this building in one way as a main downtown bank in Colorado, and the other case of a retail store; is it still your estimate that no portion of the $50,000 was because of the fact that there was a use of the building?

• • •

A I maintain the same position; that is, that the building did not have value.

Q Then what was the payment of $50,000 for? Explain that.

A It was payable for using the property, all right, which included using the building.

Q Would you be able to make an allocation of how much for the use of the building and the land?

A My judgment, shown by that chart, is that they were paying for the use of the land, that someone would have paid more to use the land than they were.

Q Who, for instance?

A The indicated value of the land indicates for parking lot purposes, or redevelopment, for a new development, that it would be returned to higher income.

Q I still want to get this straight; the $50,000 paid by the First National Bank, the total, and the Fashion Bar to the Exchange National Bank; it is your estimate that all of that was paid by them for the use of the land as separate from the use of the building?

A They were using the building, yes, sir.

Q Now, you say — would you say what the reasonable rental of the building, in your opinion, if it was a building I am talking about, what would you settle it at?

A Again, we can't separate building and land. The reasonable rental of the property is what was being paid.

Q And we are talking about the property with a building on it — we are talking about?

A Yes, sir, with that building on it.

Q If it was a vacant lot at the time, it is true that the First National Bank would not have rented that?

* * *

A The First National Bank would not have, but —

Q That is enough — and if the building had not been there in 1958 and 1959, the Fashion Bar would not have rented and paid the money on the sublease, would they?

A I would say they would not have. No, they wouldn't.

* * *

REDIRECT EXAMINATION

* * *

THE COURT: Mr. Curry, do you have an opinion as to what the highest and best use of the subject property was; that is, 18-20 South Tejon Street, in the years 1959 and 1960? Just, first of all, do you have an opinion?

THE WITNESS: Yes, sir, I do.

THE COURT: And what is your opinion?

THE WITNESS: My opinion is it should be utilized for commercial purposes. It is a downtown location, and a good site, so it has definite commercial value. The precise use I had not totally analyzed, whether it would be a higher use to use it for parking lot purposes or to construct thereon a new commercial building.

The one thing I do feel is that the use with the old building on it was not its highest and best use. * * *

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-504

WILLARD BARRY AND HARRIET BARRY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners challenge the decision below affirming the district court's finding that an antiquated building inherited by petitioner Harriet Barry ("Harriet") had no fair market value on the relevant valuation date, so that petitioners had no basis in the building with respect to which they could properly claim deductions either for depreciation or for the loss allegedly sustained by them upon demolition of the structure (Pet. App. A-1 to A-13, A-15 to A-27).

Petitioners are husband and wife. In 1959, Harriet inherited a parcel of valuable commercial property located in the downtown center of Colorado Springs, Colorado, the agreed value of which was $160,000. On the land was an antiquated stone and masonry building, which had been constructed prior to the turn of the century (Pet. App. A-3, A-15 to A-19). By the time Harriet inherited

the property, the building no longer had any forseeable economic potential as a commercial structure, and, moreover, had become a detriment to the overall value of the property (Pet. App. A-6, A-10, A-23, A-25). Various local building code violations precluded use of the upper two floors, and the general condition of the building made it economically unfeasible to remodel or rehabilitate the structure for commercial purposes (Pet. App. A-6 to A-7, A-19).

The property was previously owned by Harriet's mother, who, prior to her death in 1959, had entered into a lease agreement with a local bank, granting the bank a five-year lease of the property (commencing January 1, 1955) at a rental of $1,000 per month and an annual payment of $1,000 toward the real property taxes. Under the agreement, the bank at its option, could renew the lease for an additional five-year period, and was also authorized to demolish the building on the property at any time during the period of the leasehold without payment or compensation to the lessor. Those provisions comported with the bank's ultimate reason for acquiring the lease, which was to demolish the existing structure and utilize the underlying land for a parking lot and drive-in teller facility.

In the interim, the bank on two separate occasions subleased the property on a temporary basis in order to recoup its own rental expense. The lease was in effect at the time Harriet inherited the property from her mother. Shortly thereafter, the bank demolished the building (Pet. App. A-8, A-19 to A-20).

On their amended tax returns for 1959 and 1960, petitioners allocated a $45,000 basis to the building on the Colorado Springs property, and claimed depreciation deductions on the building. In 1960, they also claimed a

loss deduction for what they contended was their undepreciated basis in the building at the time of its demolition by the bank under the lease agreement (Pet. App. A-15 to A-16, A-21).

On audit, the Commissioner of Internal Revenue determined that the building had no separate fair market value and, accordingly, denied the depreciation and loss deductions. In a refund suit brought by petitioners, the district court found that the agreed value of the Colorado Springs property was solely attributable to the land and its advantageous commercial location, and that the antiquated building had no ascertainable fair market value on the relevant valuation date (Pet. App. A-1 to A-13). Noting the factual nature of the question of the building's valuation, the court of appeals affirmed (Pet. App. A-17 to A-27).

1. Sections 167(g) and 165(b) of the Internal Revenue Code of 1954, respectively, limit depreciation and loss deductions to a taxpayer's "adjusted basis" in his property, as that term is defined in Section 1011 of the Code. Section 1011, in turn, provides that the adjusted basis of inherited property is to be determined with reference to Section 1014, which states that a taxpayer's basis in property acquired from a decedent is the "fair market value of the property" on the date of the decedent's death or (as is the case here) on the alternate valuation date. "Fair market value" is defined as the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion and both having knowledge of the relevant facts. *United States* v. *Miller*, 317 U.S. 369, 374; *In re Williams' Estate*, 256 F. 2d 217, 218 (C.A. 9).

The burden of proof was on petitioners to establish the $45,000 value claimed on their returns. *Burnet* v. *Houston*, 283 U.S. 223, 228-229; *O'Neill* v. *Commissioner*,

271 F. 2d 44, 50 (C.A. 9). At trial, the opposing parties presented expert testimony and other evidence, much of which was conflicting as to the value of the building. Finding that all of the fair market value of the realty inhered in the land and that the building was valueless, the district court resolved this factual question in favor of the government.

Petitioners argue (Pet. 7-8) that the court of appeals improperly applied the clearly erroneous rule of *Commissioner* v. *Duberstein*, 363 U.S. 278, on the ground that this case involves disputed facts while *Duberstein* did not. But the clearly erroneous rule applies whether an issue involves the resolution of disputed factual inferences as in *Duberstein*, or conflicting testimony and evidence as in *United States* v. *Yellow Cab Co.*, 338 U.S. 338, and *Zenith Corp.* v. *Hazeltine*, 395 U.S. 100, 121-123.

At all events, the district court's finding that the building had no fair market value is supported by the evidence, which included a detailed analysis by an expert witness as well as other evidence demonstrating that the building in question no longer had any economic value[1] (Pet. App. A-10 to A-12, A-23 to A-26). On the evi-

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[1]Petitioners' various allegations (Pet. 12-16) that evidence was "improperly received" or "improperly rejected" are somewhat inaccurate. They did not assert in the court below that any evidence was erroneously received or excluded (Pet. App. A-26), and their point seems to focus merely on the relative weight which the district court accorded the testimony and other evidence presented.

Moreover, petitioners' objection (Pet. 16) to the "Levy Affidavit" is unfounded. In that affidavit, an officer of one of the former sub-lessees of the property testified that the building itself was beyond rehabilitation and that the company's sole interest in the property was its valuable commercial location. While the district court initially considered the affidavit and certain of petitioners' own evidence to be technically inadmissible, the affidavit was ultimately admitted pursuant to a stipulation agreed to by petitioners

dence presented, the district court correctly concluded that the building was a detriment to the overall market value of the property, and detracted from what would have been the fair market value of the land alone had the land been independently committed to its best and highest use (Pet. App. A-10 to A-11, A-23). While petitioners introduced certain evidence indicating that the building had a standard formula value for local property tax purposes, that evidence had little relevance to the central question of the actual "fair market value" of the building.

2. Petitioners further argue for the first time (Pet. 17-18) that the controlling issue is not the fair market value of the building, but rather the proper "determination of the proportionate share of this total value to assign to the building * * *." But even apart from their failure to press this contention below, the proposed distinction is fundamentally unsound. It is impossible to allocate fair market value between land and a building thereon without determining the fair market value of each of the component properties.[2]

Finally, contrary to petitioner's contention (Pet. 20), the decision below does not conflict with *Feldman* v.

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during the district court proceedings. (See Appendix, *infra*, pp. 1a-4a.) Once the affidavit was admitted pursuant to the stipulation, it was proper for the district court to afford the testimony therein "its natural probative effect as if it were in law admissible." *E.g., Diaz* v. *United States*, 223 U.S. 442, 450-452; *Isaac* v. *United States*, 431 F. 2d 11, 15 (C.A. 9).

[2]In the usual case, the total of the fair market value of the component properties will approximate the fair market value of the entire property. This was true in this case, except that here the fair market value of the land exceeded the fair market value of the land and the building combined because the building was a detriment to the value of the entire property.

Wood, 335 F. 2d 264 (C.A. 9), or *Hightower* v. *United States*, 463 F. 2d 182 (C.A. 5). Each of those cases involved the question whether loss deductions were allowable where the taxpayer had an established undepreciated basis in property which was subsequently demolished under the terms of a lease. Since the building in this case had no fair market value on the relevant valuation date, Harriet acquired no separate basis in the building and consequently suffered no economic loss when the building was demolished.

As the court of appeals noted (Pet. App. A-27, n. 8), any conflict between *Feldman* and *Hightower*, on the one hand, and *Landerman* v. *Commissioner*, 454 F. 2d 338 (C.A. 7), and *Foltz* v. *United States*, 458 F. 2d 600 (C.A. 8), on the other, over whether a demolition loss deduction is allowable when a lease grants the lessee the option to demolish the building but does not mandate demolition, is immaterial to this case, where Harriet was found to have a zero basis in the building.

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

JANUARY 1975.

APPENDIX

(Transcript of proceedings before district court, January 26, 1973)

[369]

(Thereupon Plaintiffs' Exhibit MM was marked for identification by the Clerk.)

MR. ROSS: Your Honor, if Mr. Barry has no objection to the introduction of that affidavit, we would forego the objection to the lease.

MR. BARRY: Well, it would be difficult. It is 1972—we made all the efforts we could to rent the building, and to come in 1972 without the affidavit, without any notice, to take his deposition—we certainly think it is admissible.

Will you mark this as one group?

Judge, may we proffer all this correspondence?

THE COURT: Well, it is evident, as I look over the documents handed to me, frankly, JJ, which purports to be a proposed short-term agreement, and MM, which purports to be a 20-year proposed lease, each being documents in which the parties are Louie N. Mullin and Fashion Bar, Incorporated; that these leases—did you come into—neither the lease nor the agreement was executed.

[370]

It would seem to me that since apparently the party is still alive who has knowledge as the other party to this transaction, Mr. Jack H. Levy, that I not receive these documents into evidence in the absence of—certainly they will only have relevance as conceivably bearing on the economic value of this property; and more specifically, as it might bear on the economic value of the structure; therefore, I do not believe that I should receive them in evidence, since they were not actually executed, and the reasons for which they were not executed would become important, and in the absence of having testimony on both sides, I would not feel it would be proper to receive the testimony of Mr. Barry.

The Government apparently is willing to receive these exhibits into evidence, provided you are willing to agree to the receipt in evidence of the affidavit of Mr. Levy.

MR. BARRY: Judge—all right.

THE COURT: I make no indication other than to indicate what Mr. Ross has just said. If the parties want to stipulate this, that is up to the parties.

* * * * *

[376]

MR. ROSS: May I be heard briefly? I am ready to withdraw any objections and put in Defendant's Exhibit 11 with the rest of these documents.

THE COURT: You are prepared to stipulate the receipt of all the letters?

MR. ROSS: —of the Fashion Bar, in return for our getting in the affidavit of Mr. Levy.

THE COURT: You are prepared to agree?

MR. BARRY: Oh, yes, sir.

THE COURT: Very well.

Under those circumstances, the proposed agreement, the proposed lease—

MR. BARRY: There are two leases. There were two proposed leases for the Fashion Bar.

THE COURT: JJ and MM was a short-term, and the other is a long-term?

MR. BARRY: Yes. They were both prepared by Mr. Miller.

[377]

THE COURT: One is JJ and one is MM, so let's —so it is stipulated then that the exhibits, which I will ask Mr. Melle to read off, that relate to the Fashion Bar, the proposed transaction, may be received in evidence, together with Government's Exhibit 11—is it?

MR. ROSS: Yes.

THE COURT: —which is the affidavit of Jack Levy, who apparently is the owner of the Fashion Bar?

MR. BARRY: Yes.

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